

Decision \_\_\_\_\_

**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

In the Matter of the Application of Watertek, Inc.,  
a California Corporation, as the sole Owner  
of Grand View Gardens, East Plano, and  
Metropolitan Water Systems, and Douglas F.  
Elliott and Catherine J. Elliott, husband and wife,  
for the following orders:

1. Authorizing Watertek, Inc., to sell and transfer to Douglas F. Elliott and Catherine J. Elliott, ownership of certain assets of Grand View Gardens, East Plano and Metropolitan water systems; and
2. Authorizing Watertek, Inc. to withdraw from providing water utility service to the Grand View Gardens, East Plano, and Metropolitan water utility customers; and
3. Granting Douglas F. Elliott and Catherine J. Elliott, a certificate of public convenience and necessity; and
4. Authorizing Douglas F. Elliott and Catherine J. Elliott, to engage in and carry on the water utility service to the Grand View Gardens, East Plano, and Metropolitan water system customers.

Application 03-05-034  
(Filed May 22, 2003)

**OPINION GRANTING APPLICATION**

**OPINION GRANTING APPLICATION****1. Summary**

Watertek, Inc., a family water service company, seeks Commission authorization to sell and transfer ownership of three small water systems, two of them near Porterville and one near Fresno. The prospective purchasers are experienced water system operators who have been operating the three water dsystems on a contract basis since April 2003. The Commission's Water Division has investigated the proposed transfer and recommends approval. The application is granted.

**2. Background**

Watertek has been owned and operated since 1986 by Raymond L. Smith and Esther F. Smith. Watertek provides water and sewer service to six Commission-regulated entities and contracts for services to one additional water and sewer company. Watertek's principal place of business is in Salinas, Monterey County. In this application, Watertek proposes selling its three Commission-regulated water companies to Douglas and Catherine Elliott of Porterville, Tulare County.

The Grand View Gardens water system serves an area near Porterville and has approximately 100 flat-rate customers. The system consists of two wells, a 3,000-gallon steel pressure/storage tank and distribution mains. The water mains are primarily four-inch standard screw and plastic pipes that are between 25 and 40 years old. The East Plano water system is also in the Porterville area, and it serves 13 customers. The system is comprised of one well, one pump, a 1,000-gallon steel pressure/storage tank, mains and related parcels of land and easements. The Metropolitan water system serves 29 customers in an area west

of Fresno, Fresno County. The system consists of one well, a steel pressure/storage tank and distribution mains. The Water Division reports that all three water systems are in compliance with county testing requirements.

In Resolution No. W-4355, dated October 24, 2002, the Grand View Gardens system was granted a general rate increase for test year 2002. This resolution ordered Watertek to update and consolidate its tariff book to include only its water systems (Grand View Gardens, East Plano, and Metropolitan), to file individual annual reports for the water systems, and to “cease adding additional systems until its other districts have been evaluated for rate increases.” In addition, the resolution states:

“Watertek has continued to expand its operations to include several new systems since 1996. Mr. Smith is responsible for seven systems in various areas of California, which could possibly place existing customers in danger due to Mr. Smith’s inability to operate that many systems efficiently.”

In this application, Raymond Smith states that he desires to sell the systems because of his age and the difficulty of serving systems that are some distance from his principal place of business. He states that the approval of the application will ensure an orderly transfer and will permit higher service quality for the customers of the water systems.

Douglas and Catherine Elliott operate a family water service company that installs pumps and provides maintenance and repair services to water systems. Douglas Elliott has provided contracted water equipment installation and maintenance and repair services to Grand View Gardens and East Plano water systems for 14 and 22 years, respectively. He holds a Grade 1 water treatment facility operator’s license, as well as a Grade 1 distribution system operator’s license. He also holds a C-10 general contractor’s license.

The Elliotts assumed all operating responsibilities for the three water systems in April 2003 and continue operating the water systems today—including bill collection, water testing, and pump maintenance. The Elliotts' place of business in Porterville is less than 10 minutes away from the Grand View Gardens and East Plano water systems, and 45 minutes away from the Metropolitan water system.

### **3. Sales Agreement**

The sales agreement calls for a purchase price of \$50,000, payable to Watertek in 180 equal payments of \$421.08, which includes both principal and interest of 6% on the unpaid balance. To evaluate whether the Elliotts will be able to handle this long-term obligation, the Water Division examined available records of the water systems, including recent balance sheets, income statements, the sales agreement and existing debt. The Water Division concluded that the Elliotts can assume this debt without incurring financial difficulty and without raising the rates of water system customers beyond what the rates ordinarily would be.

In accordance with Decision (D.) 99-10-064, Appendix D, the application forecasts the results of operation for the three water systems for the first and fifth years following acquisition. The Water Division examined these estimates, along with supporting documentation provided by the applicants.

To determine whether the buyers can service the debt load, staff employed a simplified cash flow model that excludes depreciation and other non-cash items from the income statement to determine annual net income. Traditional cash flow analysis requires analyzing changes in balance sheet accounts during the accounting period. Because staff did not have complete records for the period in question for the three water systems, it relied on the simplified cash

flow model. The Water Division concludes that its model is accurate for determining the buyers' ability to service debt and make needed capital improvements.

For 2003, the application projects a net loss of \$3,183 after loan payments, rising to a net income of \$2,828 by 2007. The Water Division evaluated the methodology and assumptions used in these projections and concluded that (1) depreciation expense was included in the net income calculation and should not have been included as a cash expense, and (2) calculation of future expenses and revenues is reasonable. Deleting the depreciation charge, the Water Division calculates a net loss of \$2,373 in 2003, increasing to a net income of \$3,634 in 2007.

For calculating cash flow, the applicants do not include any expenses for any capital outlays. That said, the applicants do include generous allowances in their results of operations forecasts for contract and professional services. Also, upon acquisition, warehouse expenses should decrease, since supplies will no longer be stored in Salinas. In examining the Elliotts' financial statements, the Water Division believes that the Elliotts will be able to make anticipated and unanticipated capital repairs and keep the water systems in good working order. The Water Division notes that the Commission in D.92-03-093 authorized Class C & D water utilities to establish a memorandum account for unanticipated repair items and recover the expenses through a surcharge mechanism. The Water Division recommends that the Elliotts establish such accounts for each of their water systems.

In summary, although there is a projected net loss for 2003, the Water Division asserts that expenses for the three water systems will actually be lower than forecast, thus resulting in positive net income.

**4. Ratepayer Indifference**

The Commission requires a test of ratepayer indifference when evaluating the sale of a public utility. Under this test, the sale of a public utility should not have any net consequences that cause the ratepayer to prefer the seller to the buyer. For example, the ratepayer should not be subject to increased rates or reduced service as the result of a change of ownership. In more recent years, the Commission has further required the buyer to demonstrate that acquisition of the public utility yields a tangible benefit to the ratepayers.

Using the ratepayer indifference test to assess the sale of the three water systems by Watertek to the Elliotts, the Water Division evaluated several key metrics including (1) the impact of purchase price on ratebase, (2) future water rates, (3) service quality, and (4) continuity of service.

The proposed purchase price of \$50,000 was arrived at by adding together the fixed assets of each water system and subtracting accumulated depreciation. Watertek provided detailed asset records for each water system. The Water Division reviewed Watertek's calculations and confirmed them with Commission adopted resolutions and annual reports filed with the Commission.

<b>Water System</b>	<b>Grand View Gardens</b>	<b>East Plano</b>	<b>Metropolitan</b>	<b>Total</b>
<b>Plant in Service</b>	\$46,862	\$2,290	\$4,249	\$53,401
<b>Accumulated Depreciation</b>	\$ 2,610	\$ 32	\$ 427	\$ 3,069
<b>Net Plant</b>	\$44,252	\$2,258	\$3,822	\$50,332

Pub. Util. Code § 2720 requires the Commission to use the fair market standard in establishing the rate base for an acquired water system. Section 2720 states:

“(a) The commission shall use the standard of fair market value when establishing the rate base value for the distribution system of a public water system acquired by a water corporation. This standard shall be used for ratesetting.

“(1) For purposes of this section, ‘public water system’ shall have the same meaning as set forth in Section 116275 of the Health and Safety Code.

“(2) For purposes of this section, ‘fair market value’ shall have the same meaning as set forth in Section 1263.320 of the Code of Civil Procedure.

“(b) If the fair market value exceeds reproduction cost, as determined in accordance with Section 820 of the Evidence Code, the commission may include the difference in the rate base for ratesetting purposes if it finds that the additional amounts are fair and reasonable. In determining whether the additional amounts are fair and reasonable the commission shall consider whether the acquisition of the public water system will improve water system reliability, whether the ability of the water system to comply with health and safety regulations is improved, whether the water corporation by acquiring the public water system can achieve efficiencies and economies of scale that would not otherwise be available, and whether the effect on existing customers of the water corporation and the acquired public water system is fair and reasonable.

“(c) The provisions of subdivisions (a) and (b) shall also be applicable to the acquisition of a sewer system by any sewer system corporation or water corporation.

“(d) Consistent with the provisions of this section, the commission shall retain all powers and responsibilities granted pursuant to Sections 851 and 852.”

The Water Division states that the purchase price of \$50,000 meets the fair market standard because it represents the depreciated assets of the three water systems.

## **5. Water Rates**

Based on the 2007 pro forma financial statements provided in the application, water rates are expected to increase between now and the year 2007 as follows:

<b>Water System</b>	<b>Average Monthly Rate – 2003 (Current tariff)</b>	<b>Estimated Average Monthly Rate - 2007</b>	<b>Percent Increase</b>
Grand View Gardens	\$46.82	\$53.72	15%
East Plano	\$42.41	\$50.99	20%
Metropolitan	\$23.78	\$51.95	118%

The ratepayer indifference test requires that projected rates be no more than if the water systems remained under the same ownership. In evaluating the estimated rates, the Water Division states that the applicants have correctly estimated projected water rates for all three water systems.

Grand View Gardens was granted a general rate increase in October 2002 by Commission Resolution No. W-4355. This resolution granted a 128% increase in revenue. The increase brought Grand View Gardens rates up to date to reflect the true cost of operating the water system. Increasing the current tariff rates by the annual CPI index raise (assumed to be 2.5%), water rates in 2007 will be \$51.70, close to the applicants' estimate. This same rationale applies to the East Plano water system.



For the Metropolitan water system, the Water Division checked the annual reports filed with the Commission going back three years. In 2000, Metropolitan recorded a net income of \$3,096. Metropolitan recorded a net loss \$5,488 in 2001 and a net loss of \$4,562 in 2002. In its review of Metropolitan's Income Statement, staff found that Metropolitan's recorded expenses and revenues were reasonable, but it also concluded that the recorded expenses are likely under-reported. Because of this, the Water Division believes that Metropolitan's rates will have to increase to meet current obligations under the current ownership and the proposed rates are in line with that increase.

Staff further notes that any future rate increases are subject to review by the Commission. The water systems will be able to charge just and reasonable rates that have been approved by the Commission. Therefore, the Water Division states that it is comfortable that the water systems' customers will not be subject to unjust water rates.

## **6. Service Quality**

The buyers have been operating the three water systems since April 2003. Because the Elliotts' business office is near the water systems, customers have routinely been dropping off their monthly bills to the Elliotts in person and reporting any water service quality issues. Catherine Elliott is at the office during normal business hours five days a week.

Watertek's principal business office is located three hours away in Salinas. Raymond Smith operates four other water/wastewater systems and was ordered by Resolution No. W-4355 not to add any additional water systems. The resolution expressed concerns that Smith, as a sole operator, may not be able to efficiently operate such a large number of systems.

There are no complaints on file with the Commission since the water systems were placed under the operation of the Elliotts. Based on our staff's investigation, we believe that it is clearly advantageous to the customers of Grand View Gardens, East Plano, and Metropolitan water systems to have the transfer go into effect. The Elliotts are experienced water utility operators, are intimately familiar with the Grand View Gardens and East Plano water systems, and are community based.

## **7. Service Continuity**

Raymond Smith is 67 years old and wishes to leave the water utility business. Douglas Elliott is an experienced water utility plant operator with a long history with Grand View Gardens and East Plano that even pre-dates Smith's involvement with these water systems. The Elliotts desire to own these water systems. Both are relatively young and live in the community.

Watertek's sales agreement with the Elliotts ensures an orderly water system ownership transition and offers continued water service by a responsible and experienced new owner. This in turn reduces the chance that these water systems will be abandoned and turned over to their respective county health departments.

## **8. Water Quality**

For Grand View Gardens, staff spoke to Pamela Moore of the Tulare County Environmental Health Department and she informed them that the water system is up to date on their testing requirements and that there are no outstanding compliance orders. Dan Gera, also of the same department, covers the East Plano system and he informed staff that East Plano is in compliance with all testing requirements and that there are no outstanding compliance orders. Robert Peterson covers the Metropolitan water system and he is with Fresno

County. Staff was unable to reach Peterson, but given the discussions with Moore and Gera, staff is reasonably confident that Metropolitan is in compliance with water testing requirements.

#### **9. Public Notification**

By letter dated April 1, 2003, Smith notified customers that he had entered into a sales agreement with the Elliotts and that they had taken over day-to-day operation of the water systems. The letter told the customers that the Elliotts would be billing them and it gave the Elliotts' contact information. It also listed the Water Division's address and telephone number.

#### **10. Conclusion**

Both parties desire the transfer of the Grand View Gardens, East Plano, and Metropolitan water systems from Watertek, Inc. to Douglas and Catherine Elliott. Raymond Smith wants to exit the water utility business because of his age and the distance of the water systems from his principal place of business. Douglas Elliott is an experienced water system operator with a long history with the Grand View Gardens and East Plano water systems and he, along with his wife, want to purchase these water systems. The Water Division recommends that the application be approved. We find that approval of the application is in the public interest in that (1) the transfer does not entail rate increases, (2) service continuity is essentially preserved, and (3) service quality will be the same or better.

#### **11. Uncontested Matter**

In Resolution ALJ 176-3114 dated June 5, 2003, the Commission preliminarily categorized this proceeding as ratesetting and preliminarily determined that hearings were not necessary. Based on the record, we conclude

that a public hearing is not necessary, nor is it necessary to alter the preliminary determinations in Resolution ALJ 176-3114.

This is an uncontested matter in which the decision grants the relief requested. Accordingly, pursuant to Pub. Util. Code § 311(g)(2), the otherwise applicable 30-day period for public review and comment is being waived.

## **12. Assignment of Proceeding**

Geoffrey F. Brown is the Assigned Commissioner and Glen Walker is the assigned Administrative Law Judge in this proceeding.

### **Findings of Fact**

1. Watertek seeks authority to transfer ownership of three small Commission-regulated water systems, Grand View Gardens, East Plano and Metropolitan, which collectively serve about 150 customers.

2. The prospective new owners, Douglas and Catherine Elliott, are experienced water system operators, and they have operated the three Watertek systems under contract since April 2003.

3. Ratepayers will benefit from the transfer because the prospective new owners are experienced in operating the three systems and are located closer to the water systems than is the current owner.

4. The Commission's Water Division has determined that the purchase price of the three systems, \$50,000, is the fair market value, as required by Pub. Util. Code § 2720.

### **Conclusions of Law**

1. Transfer of ownership of the three water systems at issue meets the test of ratepayer indifference, in that customers will be unaffected or better off in terms of service, water quality, future water rates and continuity of service.

2. The transfer of ownership will provide tangible benefits to ratepayers both in the quality and cost of water service.

3. Pursuant to California Health and Safety Code § 116525, a change in ownership of a public water system shall, and a change in regulatory jurisdiction may, require application for a new operating permit from the California Department of Health Services.

4. This is an uncontested matter in which the decision grants the relief requested.

**O R D E R**

**IT IS ORDERED** that:

1. The application of Watertek, Inc. to sell and convey the Grand View Gardens, East Plano and Metropolitan water systems to Douglas F. Elliott and Catherine J. Elliott is granted.

2. Douglas F. Elliott and Catherine J. Elliott are granted a Certificate of Public Convenience and Necessity to acquire ownership of and assume water utility service to the customers of Grand View Gardens, East Plano and Metropolitan water systems.

3. Applicants within 10 days of the transfer of ownership shall notify the Director of the Water Division in writing that the transfer has taken place, attaching copies of the transfer document.

4. Upon consummation of the transfer of ownership, Watertek, Inc. shall be relieved of public utility responsibility for the operation of Grand View Gardens, East Plano and Metropolitan water systems.

5. Douglas F. Elliott and Catherine J. Elliott are directed to comply with Section 116525(a) of the Health and Safety Code, which states: "No person shall

operate a public water system unless he or she first submits an application to the department and receives a permit as provided in this chapter. A change in

ownership of a public water system shall require the submission of a new application.”

6. Application 03-05-034 is closed.

This order is effective today.

Dated \_\_\_\_\_, at San Francisco, California.